



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201029031**

Release Date: 7/23/10

Date: April 28, 2010

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.00-00

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 16, 2010

Contact Person:

Identification Number:

Contact Number:

FAX Number:

UIL: 501.00-00

Employer Identification Number:

Legend

Date =

State =

Date2 =

Dear

We have considered your application for recognition of exemption from Federal income tax under section 501(a) of the Internal Revenue Code (Code). Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(3) of the Code. The basis for our conclusion is set forth below.

Facts:

You incorporated on Date in State, filed your initial application and, on Date2, filed an amended application. Both your original and amended organizing documents state that you are organized exclusively for charitable, scientific, and educational purposes as defined in section 501(c)(3) of the Code. Your activities include, but are not limited to acquiring, by gifts and donations, funds to be donated to other charitable entities as defined in section 501(c)(3). Your amended application added providing portable library services to your activities. Your amended bylaws state that you will further your charitable purpose by:

1. Providing advocacy, educational, and community resources to information-deprived areas in the United States and abroad;
2. Providing a forum through which networking, planning and information sharing may take place;
3. Advocating on behalf of and acting as a voice to promote literacy, learning, and access to information;
4. Conducting research, studies, and evaluations of existing programs and activities to determine their effectiveness and impact; and
5. Securing, raising and arranging capital to provide for the programs and services consistent with the purposes of the corporation.

Primarily, you maintain a website that informs visitors that they may make "free donations" by using your search engine. The searches generate advertising revenue in accordance with a standard advertising agreement. You receive the standard 60 percent of all revenue generated from countable clicks and impressions resulting from the placement of advertising materials on your website. In return, you agreed to place advertising materials provided by the company through links to the ad servers that display ad images and direct click-throughs in accordance with specifications. You also agreed to allow the company to use your name and logo in presentations, marketing materials, customer lists, financial reports, and web site listings of customers. The company claims all rights to all data collected about visitors to your website. Your agreement is perpetual but either party may terminate without cause with 30 days written notice.

Currently, the advertising fees generated by your search engine are your sole source of revenue, although in future years, when you get exempt status, you plan to solicit contributions and apply for grants. You provided sample revenue reports that list fees received by campaign categories for general consumer products such as cars, frozen food, and clothing. Your original application reports that you will contribute between 86 and 90 percent of your revenue to exempt organizations over four years. Your amended application reports that you do not plan to contribute to exempt organizations in the future.

Once a month, your users vote for the charity that will receive your donation. You established procedures for the selection of potential recipients. Users submit the names of potential recipients along with the official name of the organization, the organization's website address, contact information, and verification that the organization is recognized as exempt under section 501(c)(3) of the Code. You confirm the accuracy of the information, and, if the organization is qualified, you place the name in a pool where it will be available for random selection. You do not ask the potential recipients to submit an application or grant proposal. At all times, you retain the discretion to select the list of potential recipients and to modify that list as your board of directors deems appropriate.

You state that you operate entirely on volunteer labor, except for a small professional fee, and that you do not compensate your board members, officers, or others who may perform services for you. However, your organizing documents state that the president may receive compensation if approved by the board. You have also adopted a conflict of interest policy that explains your procedures with regard to board members that receive compensation, directly or indirectly, in exchange for services and you have a small, three-member board.

Although you continue to operate your search engine, you submitted an amended application that states that your charitable purpose is now increasing literacy and access to information in underprivileged communities by building and transporting turnkey libraries. You will spend approximately half of your revenue on expenses related to the portable library services. You plan to contact the executive administrators of domestic primary and secondary schools and libraries to encourage them to become donor institutions. A participating donor institution will submit the names of three potential recipient institutions, who are educational institutions or grassroots community groups, for eligibility. To determine the recipients' eligibility, you will question local members of the community. Next, you will ask the donor institution to collect 5,000 books to donate. When the 5,000 books are collected, you will convert a shipping

container into a library, stock it with the donated books and transport the portable library to the recipient institution at no cost. After you deliver the books, although you encourage the institutions to stay in touch, you will not offer ongoing or further assistance to these institutions.

In the future, you plan to fund your own social programs to further exempt purposes described in section 501(c)(3) of the Code. Your initial application states that your first two programs will be the installation of a free community wireless network and the organization of an ongoing food bank in an underserved area. Later, you stated that you want to develop small-scale projects worldwide.

Law:

Section 501(c)(3) of the Internal Revenue Code (Code) provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Treasury Regulations (regulations) provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(1)(iii), Example (2)(i) and (ii) of the regulations describes O as an art museum. O's principal activity is exhibiting art created by a group of unknown but promising local artists. O's activity, including organized tours of its art collection, promotes the arts. O is governed by a board of trustees unrelated to the artists whose work O exhibits. All of the art exhibited is offered for sale at prices set by the artist. Each artist whose work is exhibited has a consignment arrangement with O. Under this arrangement, when art is sold, the museum

retains 10 percent of the selling price to cover the costs of operating the museum and gives the artist 90 percent.

(ii) The artists in this situation directly benefit from the exhibition and sale of their art. As a result, the principal activity of O serves the private interests of these artists. Because O gives 90 percent of the proceeds of its sole activity to the individual artists, the direct benefits to the artists are substantial and O's provision of these benefits to the artists is more than incidental to its other purposes and activities. This arrangement causes O to be operated for the benefit of private interests in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes; or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Rev. Rul. 67-149, 1967-1 C.B. 133 held that an organization formed for the purpose of providing financial assistance to several different types of organizations which are exempt under section 501(c)(3) of the Code is itself exempt under that section. It carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals.

Rev. Rul. 76-442, 1976-2 C.B. 148, denied exempt status to an organization that provided free legal services for personal and estate tax planning for individuals who wished to make gifts to charity as part of their tax planning. The Service found that the organization was not operated exclusively for charitable purposes because its primary purpose was to provide commercial tax services to individuals who were not a charitable class. The benefits to the public were tenuous.

Rev. Rul. 77-4, 1977-1 C.B. 141 held that an organization whose only activities were preparing and publishing a newspaper of local, national, and international news articles with an ethnic emphasis, soliciting advertising and selling subscriptions to that newspaper in a manner indistinguishable from ordinary commercial publishing practices, did not qualify for recognition of exemption under section 501(c)(3) of the Code.

Rev. Rul. 80-106, 1980-1 C.B. 113, held exempt under section 501(c)(3) of the Code, an organization that operated a thrift shop that sold items on consignment. The thrift shop performed substantially all of the work without paying compensation, made all transactions at arm's length, and distributed all profits to section 501(c)(3) organizations. The ruling held that the organization is not organized and operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513.

In Better Business Bureau of Washington D.C., Inc. v. U.S., 326 U.S. 279, 66 S. Ct. 112, 90 L. Ed. 67, 1945 C.B. 375 (1945), the Supreme Court held that the presence of even a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by for-profit commercial businesses. Its primary purpose was not charitable, educational, nor scientific, but commercial. The court found that the corporation failed to demonstrate that its services were not in competition with commercial businesses.

In Arlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court found that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions on its facilities. The organization paid significant advertising and promotional expenses and derived substantial income from events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose.

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotion methods (e.g. advertising) and the extent to which the organization receives charitable donations.

Thus, the court looked at the business methods of the organization as a method of inferring whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit.

Analysis:

To qualify for exemption from tax under section 501(c)(3) of the Code, section 1.501(c)(3)-1(a)(1) of the regulations requires an organization to show that it is both organized and operated for exempt purposes and that it does not serve private rather than public interests. Based on the information you provided, we have determined that you are not organized and operated exclusively for exempt purposes, within the meaning of section 501(c)(3). You operate primarily to carry on a trade or business that is unrelated to any exempt purpose and, further, you operate for the benefit of private interests. An organization that fails either the organizational test or the operational test is not exempt.

The organizational test is set forth in Section 1.501(c)(3)-1(b)(1)(i). Your organizing documents meet the organizational test because they state that you are organized exclusively for charitable, scientific, and educational purposes as defined in section 501(c)(3) of the Code.

Next, an organization must provide information that demonstrates conclusively that it meets the operational tests described in sections 1.501(c)(3)-1(c) and (d) of the regulations which require an exempt organization to operate exclusively for one or more exempt purposes described in section 501(c)(3) of the Code and to show that it serves a public rather than a private interest. An organization will be regarded as "operated exclusively" only if it engages primarily in activities which accomplish one or more of the exempt purposes described in section 501(c)(3). The decision turns on the purpose toward which activities are directed, rather than the nature of your activities. Currently, you operate a search engine on your website to publish advertising in exchange for fees and you plan to provide assistance to organizations that donate books to the public. Neither of these activities directly implement an exempt purpose.

Publishing Advertisements

An organization that primarily operates a trade or business that is unrelated to an exempt purpose will not pass the operational test. Your primary activity is publishing advertising in exchange for fees. Generally, providing publishing services on a regular basis for fees is a trade or business ordinarily carried on for profit. See Rev. Rul. 77-4, *supra*.

Commercial Purpose

However, some organizations that operate a trade or business as a substantial part of their activities may meet the requirements of section 501(c)(3) of the Code if the activity relates to and furthers an exempt purpose. Section 1.501(c)(3)-1(e)(1) of the regulations. Several courts have considered nonprofit organizations that conduct businesses to determine whether they conducted the business to further an exempt or a non-exempt purpose.

The tax court in B.S.W. Group, Inc. v. Commissioner, *supra*, and other courts have considered whether nonprofit organizations conduct their businesses for a public or a private, commercial purpose. These courts looked for the traditional indicia of charitable purpose, public support and public control; whether the organization serves a charitable class and offers services free or below cost to that charitable class; whether the organization accumulates large surpluses; and finally, whether the organization's activities demonstrate a commercial hue. While receiving contributions from the public and having a community board are not requirements for charitable status, when an organization is conducting a business, those factors are signs that its purpose is to serve a public, rather than a private purpose. Like this organization, you conduct your business in a way that indicates that you serve a private purpose. You maintain a website through which your search engine generates your sole source of private support; advertising revenue. Your three-member professional board precludes the possibility of public control. Your website and search engine do not provide a direct benefit to a charitable class and do not offer services at or below cost to a charitable class. Although you have not yet accumulated a surplus, the totality of these factors indicates a private, rather than a public purpose.

Similarly, in Arlie Foundation, *supra.*, the court analyzed whether an organization advanced a charitable purpose by weighing factors that included competition with for-profit entities, the extent and degree of below-cost services provided, pricing policies, the reasonableness of financial reserves, commercial promotion methods and the extent of charitable donations. Competition with commercial firms was considered strong evidence of a predominant non-exempt commercial purpose. You compete with other commercial search engines for publishing dollars. You provide your publishing services to any advertiser willing to pay the standard fee. You entered into a general online advertising agreement to place advertising materials in accordance with specifications in return for the usual 60 percent of all revenue generated from countable clicks and impressions. Your revenue reports showed that the advertisements that you publish through your search engine are not for items that might further some exempt purpose, but are for general consumer products such as cars, frozen food, and clothing. To compete more successfully, you strive to increase your website traffic by misinforming your visitors that using your search engine produces a "free donation". Finally, although you make substantial charitable donations at this time, you state that you may not do so in the future. All of these factors, taken together, lend a distinct commercial hue to your publishing activity. To grant you tax exemption would unfairly disadvantage your for-profit competitors.

You suggested that you are similar to the organization described in Rev. Rul. 80-106. The ruling held that a thrift shop operated by volunteers that distributed all of its profits to organizations exempt under section 501(c)(3) of the Code was exempt. However, since your governing documents contain provisions for compensation and your application contains the vague statement that you plan to use your revenue to fund your own social programs in the future, you are not similar to the thrift shop in the ruling.

Alternatively, you suggested that you are similar to the organization described in Rev. Rul. 67-149, *supra.* The ruling held that an organization may qualify for exemption under section 501(c)(3) if it is formed to provide financial assistance to other organizations, all of which are exempt under section 501(c)(3). The ruling describes an organization that "carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to organizations that are exempt under section 501(c)(3) of the Code. You are not similar to the organization in the ruling because you do not simply "receive contributions." You operate a publishing business. You are also not similar to the organization in the ruling because you do not simply "make distributions." Although you made donations to unrelated organizations that are exempt under section 501(c)(3), you now plan to use your revenue to conduct other programs. You have failed the first part of the operational test.

Private Benefit

The operational test also places the burden of proof on an applicant to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly by such private interests under section 1.501(c)(3)-1(d)(1)(ii) of the regulations. To be recognized as exempt, an applicant must show that it does not serve private rather than public interests.

You operate for the substantial non-exempt purpose of providing a private benefit to your advertisers and other affiliates. You are similar to the museum described in section 1.501(c)(3)-1(d)(1)(iii), Example (2)(i) and (ii) of the regulations because you serve private interests. In the example, the art museum exhibited, promoted and sold art. The museum gave 90 percent of the proceeds to the artists, which was a benefit that was more than incidental to its other purposes and activities. You publish and promote the search engine on your website. You executed standard advertising agreements whereby your advertisers retain 40 percent of all revenue generated from the countable clicks and impressions resulting from the placement of their advertising materials on your website. Therefore, like the museum, you provide benefits to your advertisers that are more than incidental to any of your other purposes and activities.

You have also failed the second part of the operational test. As described above, you serve a non-exempt commercial purpose and have failed to show that you serve public rather than private interests and specifically that you are not organized or operated to benefit private interests. You particularly do not serve a public interest when you misinform the public.

To warrant exemption under section 501(c)(3) of the Code, an organization must demonstrably serve and be in harmony with the public interest. You advertise on your website that your users may make "free donations" by using your search engine. The facts and information you provided have not established that the individuals who conduct searches on your website make a purposeful payment of money or transfer of property, as required by section 170, entitling them to any tax benefit. Therefore, such statement does not serve public interests.

Donor Assistance Services

Your library assistance program provides commercially available services similar to the organization described in Rev. Rul. 76-442, *supra*. The ruling held that an organization that primarily received public contributions and offered free legal services to encourage individuals to donate funds to charitable organizations was not exempt because it was providing commercially available services to individuals. The ruling held further that incorporating others' gifts to charity does not convert an activity into a charitable activity within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations. You plan to provide assistance to encourage others to make donations. You will provide a container and transport books donated by schools to recipient communities. Assisting donors does not convert your activity into a charitable activity. Rather, it benefits the private interests of the donors, which is a non-exempt purpose. This activity fails both parts of the operational test.

As the court held in Better Business Bureau of Washington, D.C. v. U.S., *supra*, the "presence of a single [non-exempt] purpose, if substantial in nature, will destroy the exemption, regardless of the number or importance of truly [exempt] purposes." Since your two primary activities, publishing advertisements and assisting donors, advance substantial non-exempt purposes, you have failed the operational tests set forth in section 1.501(c)(3)-1(c) and (d) of the regulations. Therefore, you do not operate exclusively for exempt purposes described in section 501(c)(3) of the Code.

Conclusion:

Based on the information you provided, we conclude that you are not entitled to recognition of exempt status under section 501(c)(3) of the Internal Revenue Code because you operate for substantial non-exempt commercial purposes, and serve private rather than public interests.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE SE:T:EO:RA:2

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements